No. 15781

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of George Miller, Deceased,

Appellants,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of Delcon Corporation, Bankrupt,

Appellee.

On Appeal From the District Court of the United States for the Southern District of California, Central Division.

APPELLANTS' REPLY BRIEF.

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Preliminary Statement.

We precede this answer to the trustee's Reply Brief with a restatement of the well-established rule of law that each case must stand and be determined on its own merits, and that legal principles applicable to one set of facts are not necessarily controlling in respect to a materially different factual situation. (*Cf., Barber v. Barber,* 160 A. C. A. 15, at 18.) An examination of the Appellee's Brief reveals that no serious consideration was given by the trustee to this axiom.

We believe and respectfully contend that there is a great factual divergence between the case at bar and the cases cited in the Appellee's Brief. Clearly, trustee's reliance on the authorities cited in his brief is misplaced.

For the convenience of the court we present below a brief summary of the material facts involved in the case at bar which we believe were not present in the cases cited by the appellee, and of the controlling legal principles.

1. The instant chattel mortgage is a purchase price mortgage; the question whether recordation of a purchase price mortgage is required under Section 1957 of the California Civil Code has not as yet been adjudicated by the California State Court; and the authorities cited by appellee are inapposite to the present record.

2. On the date of consummation of the present chattel mortgage transaction (which took place more than four months preceding bankruptcy) the bankrupt-mortgagor *was solvent*. The bankrupt had no existing creditors, other than appellants to whom it was then indebted for the major part of the purchase price of the appellants' valuable property then sold to the bankrupt.

3. *Unlike the chattel mortgage transaction involved in the case of Moore v. Bay* (284 U. S. 4), the record herein does not show, and it is not claimed by the trustee, that appellants failed to record a notice of their intended chattel mortgage prior to its consummation as required by Sections 3440 and 3440.1 of the California Civil Code. *There-*

fore, the instant chattel mortgage was not conclusively fraudulent and void. (The factual setting in the *Moore* case is analyzed *infra.*)

4. On the date of the recordation of present chattel mortgage (which was also more than four months preceding bankruptcy) the bankrupt had possession of appellants' valuable business and property without payment therefor; *the bankrupt was solvent at that time and the then existing creditors were not prejudiced.*

5. The creditors who came into existence between the execution and the recordation of the present chattel mortgage (other than the appellants) were all simple creditors. Under the California state law said general creditors had no lien upon the mortgaged property by virtue of any legal proceedings; nor were they "armed with some process authorizing seizure of the property." They were not in a legal position to attack the validity of the present chattel mortgage on the basis of its assumed delayed recordation.

6. The bankrupt was admittedly in default under the terms of the valid chattel mortgage; and same was not void and fraudulent under Sections 3440 and 3440.1 of the California Civil Code. Appellants had the legal right to foreclose their security and to recapture the mortgaged property *up to and within four months of the date of bankruptcy;* and appellants were lawfully in possession of the located chattel mortgaged property prior to bankruptcy.

7. The status of a trustee in bankruptcy is determinable by the federal law. Under the Bankruptcy Law he could

not recover the property from the appellants, since appellants had obtained possession thereof *before bankruptcy. Up to bankruptcy* the trustee did not possess the right of a lien creditor. The "strong arm" doctrine, or "mythical creditor" theory is inoperative where the creditors of the bankrupt had no lien right in the mortgaged property prior to bankruptcy.

The above stated controlling legal principles are amply supported by the decisional law cited *infra*. We respectfully submit that the authorities relied on by the appellee in his Reply Brief have no factual or legal relationship to the precise problems presented for decision upon this record. As pointed out in our Opening Brief the trustee's inequitable postulate is not justified under the Bankruptcy Law in its application to the facts posed by the record herein.

We further point out *infra* that appellants are *not* foreclosed from raising the contention that the trustee was not entitled to a personal money judgment against appellants *in any amount* despite their failure to file a cross-petition for review of the Referee's order under Bankruptcy Section 39C, or despite their failure to include this contention in their Concise Statement of Points relied on.

Our answer to the contentions advanced by the trustee in his Reply Brief is amplified as follows:

I.

The Case of Moore v. Bay (284 U. S. 4) Does Not Involve the Issue of Delayed Recordation of a Chattel Mortgage Under California Civil Code Section 1957. The Decision Therein Is Predicated on the Failure of the Mortgagee to Record a Notice of the Intended Chattel Mortgage Under California Civil Code Section 3440. Therefore the Chattel Mortgage in the Moore Case Was Conclusively Fraudulent and Void Against All Creditors. Such Is Not the Case Here.

We respectfully submit that the critical facts on which the decision of the United States Supreme Court in the *Moore* case was predicated are absent in the case at bar. The facts are crystallized in the opinion of this court reported in 45 F. 2d at page 449. Reduced to essentials, they are as follows:

1. A notice of the intended chattel mortgage involved in the *Moore* case *was not recorded prior to its execution or filing in the office of the County Recorder;* and the chattel mortgage was therefore *conclusively fraudulent and void* under the express and mandatory provisions of California Civil Code Section 3440 then in force.[1]

---

[1]Civil Code Section 3440 in force prior to 1953 provided that, unless a notice of an intended chattel mortgage was recorded at least 7 days prior to its execution or filing, the chattel mortgage will be conclusively presumed to be fraudulent and void as against existing creditors. In 1953 Section 3440 was amended by adding thereto Section 3440.1 which provides, *inter-alia,* that the recording of a notice of the intended chattel mortgage must precede at least 10 days (instead of 7 days) its execution or filing. Section 3440 as amended by Section 3440.1 is set out in pertinent part in the appendix to this brief.)

2. The mortgaged property in the *Moore* case *was in the possession of the bankrupt* on date of bankruptcy; and the receiver appointed by the bankruptcy court was in lawful and physical possession thereof on date of bankruptcy and at all times thereafter.

3. The mortgaged property in the *Moore* case had not been recaptured by the mortgagee at any time prior to bankruptcy.

It is to be added that the opinion in the *Moore* case does not indicate whether the required notice of the intended chattel mortgage was ever recorded, either prior to its execution and filing, or at any time prior to bankruptcy.

It is obvious that the chattel mortgage in the *Moore* case was a nullity *ab initio* (*cf., Mitchell v. Setzler,* 84 Cal. App. 2d 716 at 720), since the objectives sought to be accomplished by recording a notice of an intended chattel mortgage under Civil Code Sections 3440 and 3440.1 were to protect all creditors against *fraudulent sales or mortgages.*

See also:

Jubas v. Sampsell, 185 F. 2d 333 (9th Cir.);

Malaquias v. Novo, 59 Cal. App. 2d 225, 138 P. 2d 729;

Woodruff v. Laugharn, 50 F. 2d 532 (cert. den.).

In the case at bar, the chattel mortgage was valid. It was not fraudulent under Civil Code Sections 3440 and 3440.1. Furthermore, the mortgaged property had been recaptured by appellants prior to bankruptcy under the provisions of their chattel mortgage in accordance with the California state law.

It is crystal clear that the decision in the *Moore* case does not sustain the trustee's inequitable dogmatic premise that appellants' chattel mortgage was void under the facts in this case.

II.

The Bankrupt Was Admittedly in Default Under the Terms of the Chattel Mortgage. Appellants Had the Legal Right to Foreclose Their Chattel Mortgage Security and to Recapture the Mortgaged Property Under the California State Law Up to and Within Four Months of the Date of Bankruptcy.

Appellants were therefore in lawful and physical possession of the mortgaged property prior to bankruptcy; and under the bankruptcy law the trustee could not reclaim it from the appellants or recover its fair value.

This precise legal point was decided adversely to the contentions of the trustee by District Judge Mathes in the recent case of *Tollefsen Trustee v. North American Van Lines,* District Court No. 18334-BH (the opinion was rendered on April 14, 1958, and is not as yet published).

The last cited case was a plenary action in which the writer of the brief was the attorney for the defendant. It was brought by the trustee in bankruptcy to recover from the defendant a voidable preference of personal property in excess of $15,000.00, and also the fair value of other personal property the defendant had recaptured from the bankrupt (when the bankrupt was insolvent) under the terms of chattel mortgages and conditional sales contract executed by the bankrupt more than four months prior to bankruptcy. Judge Mathes ruled adversely to the trustee on all of the issues in the case; and on the issue of the

legal right of the defendant to repossess the mortgaged personal property prior to bankruptcy the court stated at page 11 of its typewritten opinion as follows:

> "There is no dispute but that the chattel mortgages and conditional sales contracts were valid and were entered into more than four months before bankruptcy. If in default there can be no question, then, of defendant's right to foreclose its security according to the terms of the contracts and mortgages up to and within four months of the date of bankruptcy. (See the discussion and authorities cited in MacLachlan on Bankruptcy Section 216 (1956); and see also the discussion in *Straton v. New,* 283 U. S. 318, 325-326 (1931).)
>
> "In other words, since the contracts and mortgages were executed, were admittedly valid and were executed within four months prior to bankruptcy, the security could be foreclosed within the four-month period just the same as it could be prior to the commencement of the four-month period."

The above ruling by Judge Mathes represents the well settled law.

In 4 Remington on Bankruptcy at page 441, Paragraph 1728.3, it is stated:

> "A chattel mortgage usually gives the mortgagee the right to take possession of the property mortgaged and to foreclose in case of default, and the chattel mortgage statutes in many states make possession of the property by the mortgagee equivalent to recording of the mortgage, either directly, or by providing that the mortgage shall not be effective as against creditors unless accompanied by change of possession, etc. The mortgagee, by coming lawfully into possession of the property *before filing of the bankruptcy petition,* can

> accordingly, under such provisions, perfect his rights as against the rights of the trustee in bankruptcy of the mortgagor under §70(c) of the Act." (Italics supplied.)

Sexton v. Kesster, 225 U. S. 90, 32 S. Ct. 657, was a plenary action brought by the trustee to set aside a fraudulent preference of securities. A valid agreement was made between the defendant and the bankrupt prior to bankruptcy, under which the defendant was entitled to have possession of the securities under certain conditions. Under the terms of the agreement the securities came into the lawful possession of the defendant prior to bankruptcy, *where the bankrupt was insolvent.* The court held in an opinion written by Mr. Justice Holmes (the author of the opinion in the *Moore* case) that the trustee could not reclaim the possession of the securities. At page 659 of the opinion (32 S. Ct.) the court said as follows:

> "The bankruptcy law by itself does not avoid the transaction. (Cases cited.) A trustee in bankruptcy does not stand like an attaching creditor; he gets no lien by the mere fact of his appointment. (Cases cited.)"

It is clear that the personal judgment against the appellants for the value of the mortgaged property captured by them under the terms of their chattel mortgage in accordance with the state law prior to bankruptcy cannot be sustained under the facts in this case.

III.

The Status of a Trustee in Bankruptcy Is Defined by the Federal Law, and the Power to Attack Invalid Liens Under the State Law Is Conferred Upon Him by the Bankruptcy Act.

While the substantive law bearing on the validity of liens is determinable by the state law, the state is powerless to determine the conditions under which the trustee may attack the validity of the liens. The power of the trustee to attack validity of liens and to set aside conveyances by the bankrupt in fraud of his creditors is derived solely from Section 70 of the Bankruptcy Act.

Moore v. Bay, supra.

In *Erie Ry. Co. v. Tompkins,* 304 U. S. 64, 68, 58 S. Ct. 817, 82 L. Ed. 118, the Supreme Court declared that *except in matters governed by the Federal Constitution or by Acts of Congress* the law to be applied in any case is the law of the state.

See also:

Woods v. Interstate Realty Co., 337 U. S. at 538-539, 69 S. Ct. at 1237-1238, 93 L. Ed. 1524;

Harms v. Tops Music, etc. 160 Fed. Supp. 77 at 81.

It follows that the construction placed by the California Supreme Court on the power of a trustee in Bankruptcy under Section 70 of the Bankruptcy Act in *Noyes v. Bank of Italy,* 206 Cal. 266 at 270 (cited by appellee at p. 29 of his Rep. Br.), must yield to the construction placed thereon by the federal law explicated under the preceding heading.

Furthermore, the statement in the *Noyes* case, *supra,* relied on by the trustee in bankruptcy at pages 29-30 of his brief is only a dictum under the facts therein involved.

IV.

Under the Bankruptcy Law the Trustee Did Not Possess the Right of a Lien Creditor. The "Strong Arm" Doctrine, or "Mythical Creditor" Fiction Is Inoperative Where Simple Creditors of the Bankrupt Had No Lien on the Bankrupt's Property Prior to Bankruptcy Under the State Law.

This point is discussed at pages 27 and 28 of Appellants' Opening Brief. In addition to the cases there cited, the court's attention is respectfully invited to the following authorities:

In 3 Remington on Bankruptcy it is stated at page 564:

> "Section 70(c), like its predecessor, §47(a)(2), gives the trustee status as a creditor with lien obtained by legal or equitable proceedings *only as of bankruptcy.* Therefore, if the deed, mortgage, or contract in question was duly recorded *before that date in the manner and form required by law,* §70(c) is of no assistance. *The statute permits the trustee to conjure up a mythical creditor, but only one with a lien at date of bankruptcy.*" (Italics supplied.)

In *Bailey v. Baker Ice Machine Co.,* 239 U. S. 268, 60 L. Ed. 275, 36 S. Ct. 50, the court declared:

> "Had it been intended that the trustee should take the status of a creditor holding a lien by legal or equitable process as of a time anterior to the initiation of the bankruptcy proceeding, it seems reasonable to believe that some expression of that intention would have been embodied in §47(a) as amended. As this was not done, we think the better view, and one which accords with other provisions of the act, is that the trustee takes the status of such a creditor as of the time *when the petition in bankruptcy is filed. Here the petition was filed almost two months after*

the contract was filed for record, and therefore the trustee was not entitled to assail it under the recording law of the State." (Italics supplied.)

It bears emphasis that the mortgaged property in the case at bar was not *in custodia legis,* either on date of bankruptcy or at any other time; but that it was in the physical possession of the appellants on date of bankruptcy and for some time prior thereto.

Cf., discussion *In re New Haven Clock, etc.,* 253 F. 2d 577 (decided March 28, 1958).

We respectfully submit that under the authorities cited *supra* in this Closing Brief and under the authorities cited in our Opening Brief, the appellants' chattel mortgage which was perfected more than four months before bankruptcy was valid as against all creditors under the applicable California state law; and that in any event the trustee was not a lien creditor under the "strong arm" concept as construed under the federal law.

V.

The Other Authorities Cited in Appellee's Reply Brief Are Not in Point in Their Application to the Facts in the Case at Bar.

We respectfully submit that authorities cited in the Appellee's Brief on the issue of a delayed recordation are all predicated on divergent factual situations; and as applied to the facts in the case at bar the legal bankruptcy principles therein discussed are mere generalities. The facts in the case at bar are fairly summarized in our Opening Brief; a restatement thereof would invite a charge of redundancy, and we would not be justified to belabor further

the divergence between the facts in the case at bar and the facts in the authorities cited in the Appellee's Brief. It suffices to point to the all important following facts in the present record which were absent in the cases relied on by the appellee.

1. Appellants' purchase price chattel mortgage had been duly perfected more than four months preceding bankruptcy.

2. The bankrupt was solvent both on the date of the execution and on the date of the perfection of their chattel mortgage; and there is nothing in the record to indicate that the creditors who came into existence prior to the perfection of the chattel mortgage were in any way prejudiced because of the assumed prior delayed recordation of the chattel mortgage.

3. Appellants had the legal right to recapture the mortgaged property under the California applicable law.

4. *The recaptured mortgaged property was not in the possession or custody of the bankruptcy court at any time.*

5. Under the California law none of the bankrupt's creditors had a lien on the bankrupt's property prior to bankruptcy; that the trustee's fictitious lien did not exist before bankruptcy, and the "strong arm" doctrine or hypothetical lien creditor fiction was inoperative under the bankruptcy law.

As stated in the forepart of this brief, legal principles applied to one set of facts are not necessarily controlling in respect to a materially different factual situation.

VI.

Appellants Are Not Foreclosed From Raising the Point That the Trustee Was Not Entitled to a Personal Money Judgment in Any Amount.

The merits of this point are discussed at page 26 of our opening brief. Viewed with an eye to the merits of appellants' position, it is patently clear that appellants should not be deprived of their property rights in the mortgaged chattels and at the same time to be called upon to pay a large sum of money for their own property. We respectfully submit that the non-jurisdictional grounds urged by the trustee in opposition to our contention are without merit and not in the interest of justice. Our short answer to the following non-jurisdictional grounds urged by the trustee is as follows:

A.

The failure of appellants to file a cross-petition for review of the Order of the Referee under Section 39(c) of the Bankruptcy Act did not oust the District Court of jurisdiction to adjudicate the issue whether appellants should be saddled with any judgment in any amount. Section 39(c) must be read together with the other Sections of the Bankruptcy Act which in effect provide that courts of bankruptcy shall have jurisdiction to adjudicate all issues arising in connection with the distribution of the bankrupt's estate until the bankruptcy case is closed. Section 39(c) merely outlines the procedure to be followed in obtaining a review of a referee's order. In interest of certainty and uniformity, Section 39(c) sets forth the procedural steps to be taken in order to calendar the record before the District Judge; and the

District Judge is given the power to review the orders of the Referee *sua sponte,* or upon an informal petition, at any time before the closing of the estate.

See discussion in

2 Collier on Bankruptcy (14th Ed.), beginning at p. 1473.

Cf., Pfeister v. Northern Illinois Etc., 317 U. S. 144, 63 S. Ct. 133, at p. 137 (2, 5).

In *In re Albert,* 122 F. 2d 393, the court said at page 394, as follows:

> "We think the statutory limitation is not a condition *upon jurisdiction,* . . . *The jurisdiction of the bankruptcy court* when invoked by the filing of the petition continues until the estate is closed. (Cases cited.) Its power to review orders of referees flows from Sec. 2(10) of the Act, 11 U. S. C. A. §11(10), and nothing in Sec. 39, sub. c, expressly limits that power." (Italics supplied.)

Clearly, the District Judge had the jurisdictional power to adjudicate all the issues presented by the record, whether or not the issues are pinpointed by either of the parties.

Furthermore, the facts in the case at bar are not in dispute; *the facts* bearing on the validity of the challenged chattel mortgage are all in the present record, and the only issue before the District Court was one of law. It is well settled that the court is not bound by erroneous legal concessions of counsel.

B.

Equally, the failure of appellants to raise the above point in their Concise Statement of Points Relied On filed in this court did not deprive this court of jurisdiction to consider this all important point.

In this connection, the writer of this brief represents that he was not the trial counsel, either before the Referee or in the District Court; that he had no opportunity to become fully familiarized with the law applicable to the present record, and for this reason he inadvertently failed to include this point in the appellants' Concise Statement of Points.

Respectfully submitted,

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APPENDIX.

California Civil Code, Sections 3440 and 3440.1 cover the subject of *fraudulent conveyances.*

Section 3440 reads in pertinent part as follows:

> "CONCLUSIVE PRESUMPTION OF FRAUD. Every transfer of personal property and every lien on personal property made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred, *is conclusively presumed fraudulent and void as against the transferor's creditors.* . . ." (Italics supplied.)

Section 3440.1 reads in pertinent part as follows:

> "The sale, transfer or assignment of a stock in trade, in bulk, or a substantial part thereof, other than in the ordinary course of trade and in the regular and usual practice and method of business of the vendor, transferor, or assignor, and the sale, transfer, assignment, or mortgage of the fixtures or store equipment of a baker, cafe or restaurant owner, garage owner, machinist, cleaner and dyer, or retail or wholesale merchant, *is conclusively presumed fraudulent and void as against the existing creditors of the vendor, transferor, assignor, or mortgagor, unless before the consummation of the sale, transfer, assignment, or mortgage,* the vendor, transferor, assignor, or mortgagor, or the intended vendee, transferee, assignee, or mortgagee does all of the following:
>
> (a) Records at least 10 days before the consummation of the sale, transfer, assignment, or mortgage, in the office of the county recorder in the

county or counties in which the stock in trade, fixtures, or equipment are situated, a notice of the intended sale, transfer, assignment, or mortgage, which states the name and address of the intended vendor, transferor, assignor, or mortgagor and the name and address of the intended vendee, transferee, assignee, or mortgagee. The notice shall contain a general statement of the character of the merchandise or property intended to be sold, assigned, transferred, or mortgaged, and show the date and place where the purchase price or consideration is to be paid.

(b) Publishes at least once a copy of the notice in a newspaper of general circulation published in the judicial district in which the stock in trade, fixtures, or equipment are situated, if there is one, and if there is none in the judicial district, then in a newspaper of general circulation in the county embracing the judicial district. The publication shall be completed not less than five days before the date of the intended sale, transfer, assignment, or mortgage." (Italics supplied.)